

TEACHERS' RETIREMENT BOARD
INVESTMENT COMMITTEE

SUBJECT: Alternative Investments
Activity Status Report

ITEM NUMBER: 12

ATTACHMENT(S): 3

ACTION: _____

DATE OF MEETING: May 1, 2002

INFORMATION: X

PRESENTER(S): Réal Desrochers

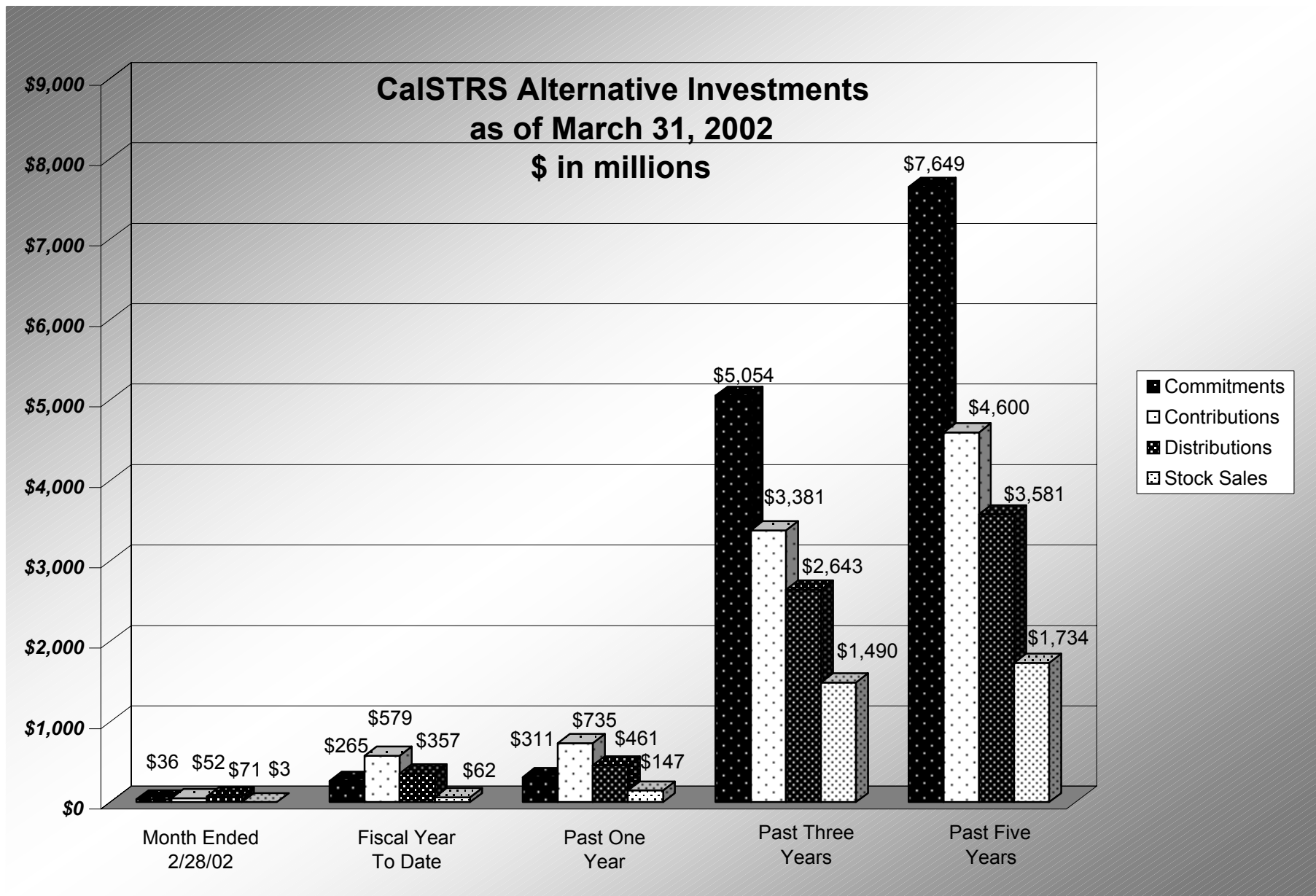
The table below contains Alternative Investment activity for the month of March 2002 and historical information for selected time periods.

| | Month Ended 03/31/02 | Fiscal Year To Date | Past One Year | Past Three Years | Past Five Years |
|-----------------------|-------------------------|------------------------|-----------------------|-------------------------|-------------------------|
| <u>Commitments:</u> | | | | | |
| Partnerships | \$ 35,655,000 | \$ 250,655,000 | \$ 250,655,000 | \$ 4,762,295,000 | \$ 7,347,387,213 |
| Co-Investments | 0 | 12,500,000 | 57,879,584 | 219,011,854 | 219,011,854 |
| Secondaries | 0 | 2,047,424 | 2,047,424 | 72,820,841 | 82,114,669 |
| | \$ 35,655,000 | \$ 265,202,424 | \$ 310,582,008 | \$ 5,054,127,695 | \$ 7,648,513,736 |
| <u>Contributions:</u> | | | | | |
| Partnerships | \$ 52,973,733 | \$ 536,486,679 | \$ 656,854,614 | \$ 3,128,047,376 | \$ 4,322,155,315 |
| Co-Investments | 0 | 22,823,508 | 53,418,764 | 147,410,519 | 147,410,519 |
| Secondaries | 56,094 | 3,336,212 | 2,345,739 | 68,733,403 | 76,422,575 |
| Mgmt. Fees (Outside) | (1,243,788) | 15,914,625 | 22,656,647 | 36,909,498 | 53,543,562 |
| | \$ 51,786,039 | \$ 578,561,024 | \$ 735,275,764 | \$ 3,381,100,796 | \$ 4,599,531,971 |
| <u>Distributions:</u> | | | | | |
| Cash | \$ 71,076,644 | \$ 302,286,826 | \$ 361,555,924 | \$ 1,163,968,478 | \$ 1,826,335,212 |
| Stock | 206,070 | 54,519,105 | 99,135,659 | 1,479,221,944 | 1,754,264,869 |
| | \$ 71,282,714 | \$ 356,805,931 | \$ 460,691,583 | \$ 2,643,190,422 | \$ 3,580,600,080 |
| Stock Sales | \$ 3,031,244 | \$ 62,368,804 | \$ 146,795,306 | \$ 1,489,655,576 | \$ 1,733,717,518 |

The chart presented in Attachment 1 illustrates the total amount of capital that CalSTRS has committed and contributed to its limited partnerships, co-investments, and secondary interests for the five year period ending March 31, 2002. The chart also illustrates the amount of distributions received and stock sold over the past five years. For the five year period ending March 31, 2002, CalSTRS has received total distributions of over \$3.5 billion, representing 78% of contributed capital.

During the month of April, staff made a \$25 million commitment to Angelo, Gordon Capital Recovery Partners III, L.P., in accordance with delegation of authority guidelines. The Executive Summary of this investment is provided in Attachment 2.

In response to the request made at the April 2002 Investment Committee Meeting, Attachment 3 describes the process for managing the Alternative Investment portfolio as it exists today and as it is envisioned post RFP. As a reminder, the conceptual design that was presented at the time of approval of the RFP is included.



Delegation #56

Alternative Investments
EXECUTIVE SUMMARY OF ACTION TAKEN
UNDER DELEGATION OF AUTHORITY
AG CAPITAL RECOVERY PARTNERS III, L.P.

Action: Commit up to \$25 million in the Angelo, Gordon Capital Recovery Partners III, L.P. ("AGCR III").

Background: Angelo, Gordon & Co., L.P. ("Angelo Gordon") is seeking \$1 billion in commitments for their third private equity fund dedicated to distressed debt investing. Angelo Gordon has been investing in distressed debt securities (and other non-traditional assets) since its founding in 1988.

At present, Angelo Gordon employs 90 people, 36 of whom are involved in research. The firm manages approximately \$8 billion of assets, of which 34% is invested in distressed debt securities.

CalSTRS has not previously invested with Angelo Gordon.

Analysis: With respect to AGCR III, Angelo Gordon will employ the same distressed debt investment strategy and methodology that it has utilized over the past 13 years. Investments will typically consist of secured and/or other senior debt instruments of troubled companies. Because of their priority in a company's capital structure, these investments are relatively unaffected by swings in the equity markets - particularly when compared to more junior, higher risk/reward securities such as subordinated debt. The collateral and legal safeguards offered by secured and senior debt provide a value oriented margin of safety for investors as well as legal leverage in what is often a contentious struggle between senior and junior creditors over a limited pool of assets.

Investment Thesis: Staff recommends an investment in AGCR III because now is an opportune time to make distressed debt investments and the Angelo Gordon team is one of the most experienced, well respected and proven successful investors in this field.

Factors making this a good time to invest in distressed debt include:

- The supply of defaulted and distressed debt drives the level of investment opportunities available to distressed debt investors and the supply of such has never been higher.

- In addition to a lower risk profile, the expected returns associated with distressed debt investing are attractive because they tend to be counter-cyclical to some degree. This is because distressed debt opportunities increase in bad economic times and periods of tight credit – conditions that generally impair the performance of our other types of funds.

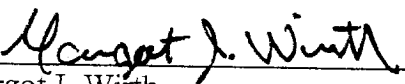
Factors in favor of investing with Angelo Gordon include:

- Angelo Gordon has one of the oldest, largest and well-respected distressed debt businesses in the country. It is backed-up by a larger organization specializing in non-traditional investments that has exhibited generally stable operations and high performance since 1988.
- Angelo Gordon has demonstrated a highly disciplined approach to distressed debt investing -- it has remained focused on its core expertise in good times and bad. It has generally avoided making investments in industries in which it lacked expertise and/or in businesses in which it could not fully analyze and/or comprehend for whatever reasons (e.g., lack of transparency in the financial statements, etc.).

Policy Compliance: This decision complies with the portfolio's policies and procedures, which were approved by the Investment Committee on June 3, 1998. Positive written recommendations by the Alternative Investments consultant and CalSTRS' staff have been documented. The investment analysis and due diligence were conducted in the manner previously reviewed and approved by the Investment Committee.

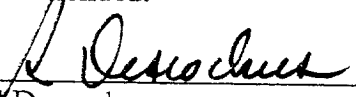
Recommendation: Staff recommends that CalSTRS invest up to \$25 million in the Angelo, Gordon Capital Recovery Partners III, L.P. subject to successful negotiation of terms and conditions and legal review.

By:


Margot J. Wirth
Investment Officer


Date 4/2/02

Recommended:


Réal Desrochers
Director of Alternative Investments

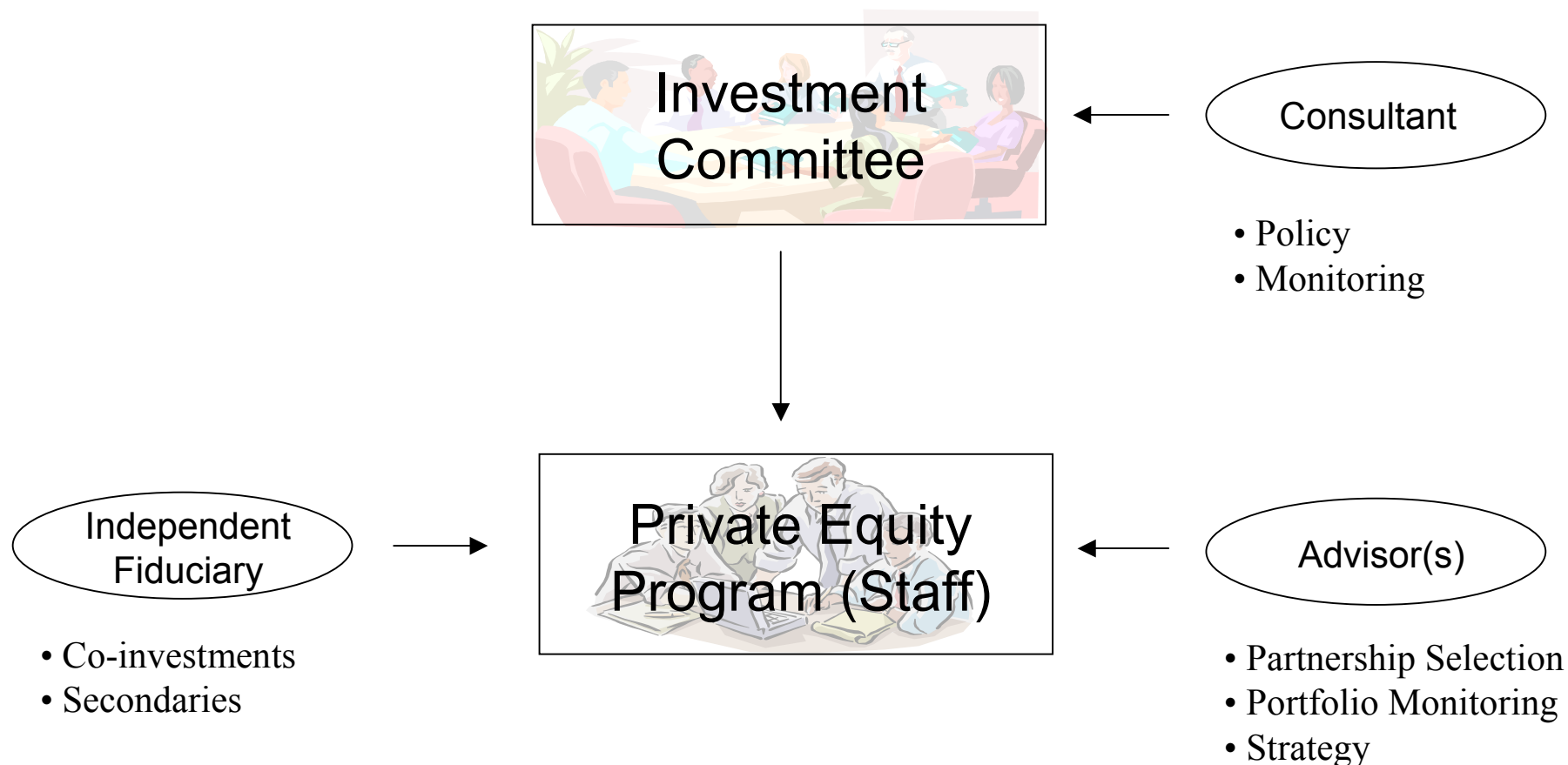
Date April 2, 02.

Approved:


Christopher J. Ailman
Chief Investment Officer

Date 3 April 02

CalSTRS Business Model





California State Teachers' Retirement System Asset Base (as of 2/28/02)

Total Assets - \$100 billion

Portfolios

| Equity | Fixed Income | Real Estate | Alternative Investments |
|---------------|--------------|----------------|-------------------------|
| 60% | 28.5% | 5.3% | 4.4% |
| \$ 60 billion | \$29 billion | \$ 5.2 billion | \$ 4.4 billion |

(Performance Measurement, Accounting, Reporting and Monitoring)

| | | | | |
|-------------------------|--------------|--------------|--------------|------------------------------|
| Performance Measurement | State Street | State Street | Consultant | Advisor / Gatekeeper |
| Investment Accounting | State Street | State Street | State Street | Advisor / Gatekeeper |
| Monitoring | Staff | Staff | Staff | Staff / Advisor / Gatekeeper |



ALTERNATIVE INVESTMENTS - PROCESS

| Performance Measurement/Accounting/Reporting/Monitoring | | |
|---|--------------------------|---|
| | <u>CURRENT</u> | <u>POST RFP</u> |
| Performance Measurement/Reporting | Advisor/Gatekeeper | I.C. ⁽¹⁾ Consultant - Reports State Street - Performance Measurement |
| Investment Accounting | Advisor/Gatekeeper | State Street (PrivateEdge) |
| Monitoring | Staff/Advisor/Gatekeeper | Staff/Independent Fiduciary and/or Advisors/Gatekeeper |

| Investment Management | | |
|-------------------------------|--|--|
| | <u>CURRENT</u> | <u>POST RFP</u> |
| Partnership Investment | Staff and Advisor/Gatekeeper | Staff and Various Advisors/Gatekeeper Divided by Segment |
| Co-Investment | Staff and/or Advisor/Gatekeeper or Independent Fiduciary | Same |
| Secondary Interest | Staff and Advisor/Gatekeeper | Staff/Independent Fiduciary and/or Advisors/Gatekeeper |

⁽¹⁾ I.C. - Investment Committee